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SUBJECT: PROTESTERS ANGRY OVER LOSSES RELATED TO LEHMAN-
ISSUED DEBT INSTRUMENTS

¶1. Summary: On September 21, Hong Kong's Democratic Party (DP) organized a protest by approximately 500 individuals who hold a structured debt instrument issued by Lehman Brothers. They claimed the investment's risk profile was misrepresented to them by the local commercial banks who distributed it. Local media reported on September 22 that thousands of HK residents may hold as much as USD 1.6 billion (HKD 12.7 billion) of the Lehman-issued paper. HKG officials warned investors that their losses would likely be significant, and the chairman of the DP threatened to organize a class-action lawsuit. Although the Hang Seng Index (HSI) closed up 1.6 percent on September 22, and trading volumes and inter-bank interest rates stabilized, local newspaper editorials forecast further market turbulence. They said the USG plan to purchase distressed mortgage-related paper would significantly increase the USG's total debt, depreciate the U.S. dollar (to which the Hong Kong dollar is pegged), and result locally in increased commodity prices and interest rates. End summary.

Lehman "Minibond" Holders Stage Protest

¶2. On September 21, in a march organized by Hong Kong's Democratic Party, approximately 500 retail investors holding "minibonds" issued by Lehman Brothers marched to the headquarters of Hong Kong's Securities and Futures Commission (SFC). (Note: Minibonds are fixed income debt instruments with an appreciation potential linked to the trading prices of several blue chip stocks on the HSI.) The individual investors claimed the risks involved with the Lehman-issued minibonds were not accurately represented to them by the local commercial banks who distributed them. The investors face losses totaling at least 75 percent of their minibond holdings. SFC CEO Martin Wheatly told Chinese-language newspaper Ming Pao on September 22 that Lehman issued approximately USD 1.6 billion (HKD 12.7 billion) of minibonds in Hong Kong, accounting for 40 percent of the total market share of these structured finance products.

¶3. Thirty representatives of the protesting retail investors raised their concerns on September 22 with officials from the Hong Kong Monetary Authority (HKMA), SFC and banks that served as trustees for the paper (e.g. HSBC). HKMA Executive Director Raymond Lee told the press after the meeting that the HKMA would urge the distributor banks to contact their retail investors and inform them of their holdings of the Lehman-issued minibonds. Lee said the HKMA would enforce disciplinary action against any banks that committed "irregular activities" with regard to selling the minibonds to retail investors.

¶4. Democratic Party Chairman Albert Ho, a lawyer, said his party was considering whether to file a class action lawsuit on behalf of retail investors who purchased the Lehman minibonds.

Hang Seng, Interest Rates Stabilize

¶5. Hong Kong's Hang Seng Index (HSI) closed 1.6 percent higher on

September 22, as trading volume and volatility returned to more normal levels. Analysts awaited further word from the United States regarding the USG's proposed plan to purchase up to US\$ 700 billion of illiquid mortgage-related securities.

¶16. HIBOR inter-bank loan market rates differed little from the previous trading day. At 1620 HRS local time, HIBOR rates were as follows: overnight 2.5 percent; one week 2.75 percent; one month 3.35 percent; three and six months 3.05 percent.

HK Media Skeptical About USG Efforts

¶17. While HKG officials made no substantive public comments on September 22 concerning the USG's plan to purchase up to USD 700 million of distressed mortgage-related debt instruments, local media were very vocal. The local Chinese press warned that the USG might have to pay a high longer-term price for its "market rescue measures." The independent Hong Kong Economic Times editorialized on September 22 that the USG's debt financing of its various bailout plans would drive Treasury yields higher and result in higher interest rates for U.S. businesses. The editorial also stated that the U.S. dollar would likely depreciate, thereby possibly triggering "another round of global financial turmoil." (Note: The Hong Kong dollar's value is pegged to the U.S. dollar, which means Hong Kong must follow U.S. interest rate policy, even if not appropriate for local inflation and growth rates. End note.)

¶18. The independent Hong Kong Economic Journal opined that "a complete reform of the U.S. financial sector is inevitable," in the wake of the USG's response to the financial crisis. The journal

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said investors are losing confidence in the operating models of U.S. investment banks, as well as their related regulatory mechanisms.

¶19. Meanwhile, an editorial in the pro-Beijing Ta Kung Pao daily newspaper expressed skepticism about the effectiveness of the USG rescue plan, saying it might trigger more financial turbulence. The newspaper said the U.S. national debt would increase significantly, which in turn would cause a depreciation of US dollar, rising interest rates, and higher commodity prices. Ta Kung Pao warned that Hong Kong and Mainland holders of U.S. dollar assets such as Treasuries would ultimately suffer along with the U.S. economy.